

**THE OFFICE OF REGULATORY STAFF**

**DIRECT TESTIMONY**

**OF**

**THOMAS H. ALLEN**

**June 18, 2014**



**DOCKET NO. 2014-4-G**

**ANNUAL REVIEW OF  
PURCHASED GAS ADJUSTMENT AND  
GAS PURCHASING POLICIES OF  
PIEDMONT NATURAL GAS COMPANY, INC.**

**DIRECT TESTIMONY OF THOMAS H. ALLEN**

**ON BEHALF OF**

**THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**

**DOCKET NO. 2014-4-G**

**IN RE: ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT ("PGA")**

**AND GAS PURCHASING POLICIES OF PIEDMONT NATURAL GAS**

**COMPANY, INC.**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.**

**A.** My name is Thomas H. Allen. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the Office of Regulatory Staff ("ORS") as the Manager of the Gas Department.

**Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

**A.** I received a Bachelor's degree in 1995 and a Master's degree in 1999 from the University of South Carolina. In August 2007, I joined ORS in the Telecommunications Department. In February 2013, I joined the Gas Department in my current position. I have testified on several occasions before the Public Service Commission of South Carolina ("Commission") relating to telecommunications regulatory compliance matters and natural gas regulatory matters.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

**A.** The purpose of my testimony is to set forth the ORS Gas Department's findings regarding the review and examination of the purchasing policies of Piedmont Natural Gas

Company, Inc. ("Piedmont" or "Company"), including the hedging program, and the administration of their Commission approved Gas Cost Recovery Mechanism ("GCRM") tariff.

**Q. WHAT IS THE REVIEW PERIOD FOR THIS PROCEEDING?**

**A.** The review period is the twelve-month period April 1, 2013 through March 31, 2014.

**Q. PLEASE DISCUSS PIEDMONT'S PURCHASING PRACTICES.**

**A.** Piedmont contracts with several interstate pipeline companies for transportation capacity, storage service and liquefied natural gas ("LNG") peaking service; they purchase commodity supply from a number of producers and marketers to both meet the needs of its firm customers on a peak design day, as well as its firm and interruptible customers' annual usage requirements. Since it is imperative that the volume of gas required for the firm class of customers be available on the peak day, it would be inappropriate for the Company's plans to include the use of interruptible resources for pipeline transportation, storage service, peak shaving capacity, or commodity supply to meet this obligation. Customers who are dependent upon firm natural gas service for heating, cooking, water heating and other essential needs, expect the natural gas supply to be available. Firm customers have no alternate fuel capability and must have natural gas available 365 days a year.

**Q. PLEASE DESCRIBE PIEDMONT'S CAPACITY AND SUPPLY CAPABILITIES FOR THE REVIEW PERIOD USING THE COMPANY'S UPDATED DESIGN DAY CALCULATION.**

1     **A.**           For the Carolinas, Piedmont had firm sendout capacity capability available for the  
2           Firm Design Day for FY2014. The capacity portfolio to meet this demand included firm  
3           transportation contracts on the interstate gas pipeline systems of Transco, Columbia Gas,  
4           and East Tennessee. Also, the Company had storage service available from Hardy  
5           Storage, Dominion, Columbia Gas, and Transco. In addition, Piedmont had its two local  
6           LNG peaking facilities located in Huntersville and Bentonville, North Carolina as well as  
7           contracted LNG peaking service with Transco. These sources were available to inject  
8           additional natural gas into its system, when needed, to balance flowing supplies with the  
9           Company's system load requirements.

10           Piedmont purchased gas supply under a diverse portfolio of contractual  
11           arrangements with a number of gas producers and marketers. Under the firm gas supply  
12           contracts, Piedmont pays market-based commodity prices tied to indices published in  
13           nationally recognized industry publications. Piedmont also purchased gas supplies in the  
14           spot market under contract terms of one month or less.

15     **Q.   WERE   PIEDMONT'S   CONTRACTED   CAPACITY   AND   SUPPLY**  
16           **CAPABILITIES SUFFICIENT TO MEET THE REQUIREMENTS OF ITS FIRM**  
17           **CUSTOMERS?**

18     **A.**           Yes. For the review period, ORS's examination indicated the Company had  
19           adequate firm assets, through both capacity and supply contracts, to meet its firm  
20           customers' requirements. ORS recommends that the Company continue to monitor its  
21           firm capacity and supply capabilities, with regard to future demand on the system as well  
22           as changes being experienced in the natural gas industry.

**Q. DID ORS CONCLUDE THAT THE COMPANY ACTED APPROPRIATELY IN PURCHASING GAS CAPACITY AND SUPPLY TO MEET THE REQUIREMENTS OF ITS CUSTOMERS?**

**A.** Yes. The Company uses what is called a "best cost" gas purchasing policy. This policy consists of five main components -- price, security, flexibility, deliverability and supplier relations. These components are all interrelated and weighed based on their importance. Piedmont has been very active in purchasing supplies directly in the market and making arrangements through interstate pipelines for capacity required for the transportation delivery and storage of these supplies. ORS's observations of Piedmont's gas purchasing policies indicate that Piedmont is continuing its efforts to get reasonable terms through negotiations of their contracts. Piedmont has also been very active in the Federal Energy Regulatory Commission ("FERC") proceedings concerning interstate transportation and storage rate changes, as well as other issues concerning the FERC regulated interstate pipeline companies.

**Q. PLEASE DISCUSS PIEDMONT'S HEDGING PROGRAM.**

**A.** Piedmont's original hedging program was approved by the Commission on March 26, 2002 in Order No. 2002-223 in Docket No. 2001-410-G. This order allowed the hedging of up to sixty percent (60%) of the Company's annual normalized sales volumes.

On May 25, 2005, the Commission issued Order No. 2005-287 in Docket No. 2005-146-G approving limited modifications to the hedging program to increase Piedmont's flexibility in making both time-driven and price-driven hedges.

On October 11, 2006, the Commission issued Order No. 2006-527 in Docket No.

2006-4-G which modified Piedmont's GCRM to reflect hedging activity results in the deferred account #253.04, on a monthly basis, as requested by ORS.

By Petition dated November 25, 2008, Piedmont sought approval to reduce the hedging "horizon" utilized from twenty-four (24) months to twelve (12) months. Upon approval of this modification, set forth in Commission Order No. 2009-37 in Docket No. 2001-410-G, dated February 11, 2009, Piedmont is approved to hedge gas costs twelve (12) months in advance of the current period. By Petition dated October 1, 2009, Piedmont requested approval to reduce the percentage range of its normalized annual sales volumes that can be hedged from a range of 30% to 60% down to 22.5% to 45%. On October 15, 2009, this modification was approved in Commission Order No. 2009-728 in Docket No. 2001-410-G.

By Petition dated October 7, 2011, Piedmont proposed a modification of its hedging program that would allow the Company to hedge its gas costs at levels below the current minimum of 22.5% of annualized sales volumes, including the possibility of placing no hedges at all. Specifically, Piedmont proposed to modify the time-driven component of its Hedging Program such that no hedges will be placed for any period where the futures price of natural gas is at or above the 60<sup>th</sup> decile level compared to the average historic price of gas as calculated under Piedmont's Hedging Program. On November 18, 2011, this modification was approved in Commission Order No. 2011-833 in Docket No. 2011-419-G.

**Q. WHAT ARE THE RESULTS OF PIEDMONT'S HEDGING PROGRAM FOR THE REVIEW PERIOD?**

1     **A.**             For the review period, the Company's hedging program for South Carolina  
2             operations resulted in a net economic benefit of approximately \$776,800, recorded in  
3             deferred account #253.04.

4             Based upon ORS's review and examination, ORS found that:

- 5             **(1)**     the percentage of volumes hedged were no greater than forty five percent (45%)  
6             of annualized sales volumes;
- 7             **(2)**     the time period for which the hedges were purchased was no greater than twelve  
8             (12) months;
- 9             **(3)**     the hedging tool used was a call option;
- 10            **(4)**     the amount paid to purchase the option, referred to as the premium, was no more  
11            than the plan's approved percentages of 4% to 6% of the applicable NYMEX  
12            futures price;
- 13            **(5)**     the strike price of the call options purchased were secured at the prevailing market  
14            prices or lower; [Note: The strike price is the price the option holder must pay to  
15            exercise the option.]
- 16            **(6)**     the costs of the hedging program were properly recorded; and,
- 17            **(7)**     the Company filed monthly reports with the Commission and ORS providing the  
18            results of the hedging program. ORS determined that Piedmont operated its  
19            hedging activities in compliance with the Commission approved program and has  
20            no recommendations to change the Company's current hedging program.

1 **Q. DID ORS REVIEW THE COMPANY'S FORECASTED FIRM DESIGN DAY**  
2 **REQUIREMENT FOR THE UPCOMING 2014-2015 WINTER SEASON AND**  
3 **THE COMPANY'S STEPS TO MEET THIS REQUIREMENT?**

4 **A.** Yes. ORS reviewed and examined the Company's forecasted Firm Design Day  
5 requirement for the upcoming FY2015 winter season and the measures the Company is  
6 taking to ensure the reliability of the capacity and supplies. Piedmont has taken a number  
7 of steps in securing firm capacity and supply for future demand on its system. These  
8 steps include contracting with interstate pipelines for capacity on their systems, acquiring  
9 storage capacity, LNG capabilities and negotiating contracts with suppliers. Upon review  
10 of projections of Piedmont's Carolinas Firm Design Day requirement and the assets  
11 currently in place to satisfy this requirement, ORS finds Piedmont's plan for the FY2015  
12 winter season to be reasonable.

13 Also, ORS reviewed the Company's decision to subscribe to 120,000 dekatherms  
14 of transportation capacity on two (2) of Transco's expansion projects tentatively  
15 scheduled to begin transportation service in 2015. This capacity will allow the Company  
16 to diversify its supply portfolio by accessing production from the prolific Marcellus shale  
17 supply basin.

18 Piedmont has an obligation to maintain adequate supplies at just and reasonable  
19 costs to serve its customers. Based on our review of information provided by Piedmont,  
20 ORS finds that the Company is prepared to meet its obligation. For future planning  
21 periods, ORS recommends that the Company continue its practice of monitoring its firm

1 transportation, storage, supply and LNG capabilities based upon its forecasted firm  
2 demand and continuing changes in the natural gas industry.

3 **Q. PLEASE DESCRIBE PIEDMONT'S APPROVED GCRM.**

4 **A.** Piedmont's GCRM is designed to permit the Company to recover the prudently  
5 incurred actual cost of gas from its customers. The actual cost of gas consists of two (2)  
6 components: a Demand cost of gas and a Commodity cost of gas. The Demand  
7 component includes all capacity charges for the transportation and storage of gas. The  
8 Commodity component is comprised of charges for the volumes of gas purchased. The  
9 GCRM provides that Piedmont establish a Benchmark Commodity Cost of Gas which is  
10 the Company's estimate or forecast of the City Gate Delivered Cost of Gas for gas  
11 supplies, excluding Demand Charges. The GCRM provides for the recording of the  
12 monthly differences between the actual cost of gas purchased and the rate billed to the  
13 customer, to the Company's Deferred Account #253.04.

14 **Q. DOES PIEDMONT'S APPROVED GCRM ALLOW FOR ADJUSTMENTS TO**  
15 **THE BENCHMARK COMMODITY COST OF GAS?**

16 **A.** Yes. The Benchmark Commodity Cost of Gas may be adjusted to recognize  
17 changes in the billing factor for the amount to be recovered. These requests are filed with  
18 the ORS for review and the Commission for approval. The GCRM also allows for the  
19 same type adjustment for the Demand Cost of Gas Component, although the Demand  
20 Component does not change as frequently as the Commodity Cost of Gas Component.

21 **Q. WHAT IS THE CURRENT BENCHMARK COST OF GAS INCLUDED IN THE**  
22 **COMPANY'S RATES?**

1    A.           The current Benchmark Commodity Cost of Gas, GCRM -138, included in the  
2           Company's rates is \$4.00 per dekatherm, which became effective with the first billing  
3           cycle of February 2014. ORS does not recommend any change to the Benchmark  
4           Commodity Cost of Gas at this time.

5    **Q.    DID THE COMPANY ADMINISTER ITS GCRM DURING THE REVIEW**  
6           **PERIOD IN ACCORDANCE WITH THE COMMISSION APPROVED TARIFF?**

7    A.           Yes.

8    **Q.    DOES THIS CONCLUDE YOUR TESTIMONY?**

9    A.           Yes, it does.